Maryland’s $2.8 Billion Missed Opportunity

Cleaning Up Our Tax Code Would Have Raised $2.8 billion from 2014 to 2018

An effective revenue system is an essential tool to enable Maryland to invest in the foundations of our economy such as education, health care, and transportation. Just as importantly, a fair tax system is essential to push back against the increasing concentration of wealth and power in a few hands. All Marylanders benefit when we have sufficient resources to invest in the basics, and these investments can be particularly important to break down the barriers—built through past and present policies—that hold back many Marylanders because of their race, gender, a disability, or another aspect of their identity.

Maryland’s current revenue system has significant shortcomings, but we can make it more effective and more equitable if we take a few steps to eliminate corporate loopholes, ineffective tax subsidies, and other special interest tax breaks.

As Marylanders’ needs grow and our revenue system falls further behind, it is vital that policymakers act swiftly. The fact is, we have already lost billions by failing to act sooner. If we had eliminated corporate loopholes, ineffective tax subsidies, and other special interest tax breaks, Maryland could have raised an additional $2.8 billion in revenue between fiscal years 2014 and 2018—years in which the lingering shadow of the Great Recession made it harder to invest in the things, like great public schools and accessible child care, that support a thriving community.1 We now have a chance to avoid making the same mistake.

Summary of Forgone Revenue from Putting Off Tax Reform ($ Millions)

<table>
<thead>
<tr>
<th>Revenue option</th>
<th>FY 2014</th>
<th>FY 2015</th>
<th>FY 2016</th>
<th>FY 2017</th>
<th>FY 2018</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Corporate Tax Loopholes</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Combined reporting</td>
<td>$17.40</td>
<td>$61.60</td>
<td>$65.70</td>
<td>$73.90</td>
<td>$76.80</td>
<td>$295</td>
</tr>
<tr>
<td>Throwback rule</td>
<td>$39.30</td>
<td>$39.60</td>
<td>$42.10</td>
<td>$47.10</td>
<td>$52.10</td>
<td>$220</td>
</tr>
<tr>
<td>Close the LLC loophole</td>
<td>$234.70</td>
<td>$246.40</td>
<td>$256.50</td>
<td>$264.80</td>
<td>$275.40</td>
<td>$1,278</td>
</tr>
<tr>
<td><strong>End Ineffective Subsidies</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>$29.50</td>
<td>$36.00</td>
<td>$39.60</td>
<td>$43.00</td>
<td>$45.70</td>
<td>$194</td>
</tr>
<tr>
<td><strong>Special Interest Tax Breaks</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Offset capital gains special treatment</td>
<td>$78.20</td>
<td>$84.30</td>
<td>$90.90</td>
<td>$98.30</td>
<td>$103.60</td>
<td>$455</td>
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<tr>
<td>Close the carried interest loophole</td>
<td>$48.00</td>
<td>$23.40</td>
<td>$39.70</td>
<td>$46.50</td>
<td>$51.70</td>
<td>$209</td>
</tr>
<tr>
<td>Fix the millionaire estate tax</td>
<td>$0.00</td>
<td>$0.00</td>
<td>$23.10</td>
<td>$47.40</td>
<td>$77.40</td>
<td>$148</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$447</td>
<td>$491</td>
<td>$558</td>
<td>$621</td>
<td>$683</td>
<td>$2,800</td>
</tr>
</tbody>
</table>
Past Missteps

Maryland state and local revenues fell sharply after the Great Recession. While the state did take some positive steps to protect essential services, these steps were not sufficient to prevent harmful cuts. If policymakers cleaned up our tax code, we could have avoided or eased service reductions that harmed communities across the state:

- Maryland made significant progress strengthening our investments in public schools in the early years of this century. Lawmakers set an ambitious standard for school funding in 2002, and by 2008 all but one of the state’s 24 school districts were funded at or close to that standard.ii But gradual funding cuts brought the number of well-funded districts to only six by 2015, nearly wiping out the gains made in the previous period. By that time, more than half of Black students in Maryland went to school in a district that was underfunded by 15 percent or more—a situation that as of 2017 was essentially unchanged. This underinvestment in public schools weakens Maryland’s economy in the long term and violates the state’s constitution to provide a quality education to every child.

- For multiple years, working parents in Maryland had less access to child care assistance than those in most other states. Nearly 3,200 children were eligible for subsidized child care but were put on a waiting list because of insufficient resources in mid-2015.iii That number increased to more than 4,300 by late 2017. During the same period, the state paid child care providers a monthly rate $325 below the federally recommended level, meaning that even parents who received assistance could choose from only a short list of providers who would accept the state’s rate. Thanks to significant increases in federal funding, the state has made major improvements in recent years—but better tax policies would have allowed us to do more, sooner.

- This is only a small sample of the services that were affected by ineffective tax policies amid a slow economic recovery. As of late 2017, legislative analysts estimated that state agencies were understaffed to the tune of about 2,500 workers.iv There simply were not enough hands to deliver a wide range of state services effectively.

Present Opportunities

If policymakers act now to clean up Maryland’s tax code, we can move onto a different path, strengthening the foundations of our economy and ensuring Maryland communities can thrive for decades to come. It is especially vital that lawmakers work to fix our tax code this year, as they consider major new investments in world-class public schools. These new investments have potential to build a brighter future for children across Maryland, and it is essential that we back them with sufficient resources rather than repeat our past mistakes.
Appendix: Data Sources and Methodology

Combined Reporting

**Description:** Enact combined reporting, a method of calculating corporate income tax responsibilities in which all members of a corporate group (such as subsidiaries and parent companies) are treated as a single entity.

**Data sources:**

- SB 469 of 2013 Fiscal and Policy Note
- SB 395 of 2014 Fiscal and Policy Note
- SB 179 of 2015 Fiscal and Policy Note
- SB 432 of 2016 Fiscal and Policy Note

**Methodological notes:**

- Each year’s estimate is taken from the most recent fiscal note that includes that year.
- For bills with multiple tax provisions or local revenue impacts, only the all-funds state revenue impact of combined reporting is used.

Throwback Rule

**Description:** Enact the throwback rule, a rule used in calculating Maryland’s share of a multistate corporation’s profits. When a Maryland-based corporation makes sales into a state that lacks the authority (nexus) to tax the resulting profits, the throwback rule requires those profits to be attributed to Maryland.

**Data sources:**

- SB 800 of 2011 Fiscal and Policy Note
- SB 833 of 2017 Fiscal and Policy Note

**Methodological notes:**

- Each year’s estimate is taken from the most recent fiscal note that includes that year.
- For bills with multiple tax provisions or local revenue impacts, only the all-funds state revenue impact of the throwback rule is used.
- Neither fiscal note includes a revenue estimate for FY 2017. This memo assumes the FY 2017 impact is the average of the FY 2016 impact (estimated in 2011) and the FY 2018 impact (estimated in 2017).

Close the LLC Loophole

**Description:** Levy a 4 percent tax on the profits of the largest S-corporations, partnerships, and LLCs, which are exempt from the federal and state corporate income tax. Every company’s first $1 million in profit is exempt, and sole proprietorships are entirely exempt.
Data sources:

- HB 507 of 2020 Fiscal and Policy Note
- Bureau of Economic Analysis data on Maryland and nationwide personal income
- Congressional Budget Office projections of nationwide personal income

Methodological notes:

- Revenue impact was projected backward based on estimated growth in Maryland personal income.
- Maryland personal income for FY 2021 to 2025 was estimated based on Congressional Budget Office estimates of nationwide personal income.
- It was assumed that future quarterly growth in Maryland personal income will equal quarterly growth in nationwide personal income, minus the average difference in growth rates between Maryland and nationwide personal income from 2013 to 2019.

End Ineffective Subsidies

Description: Repeal certain business tax subsidy programs that the Department of Legislative Services to be ineffective or lack evidence of effectiveness. The revenue estimate includes the following programs: Enterprise Zones, Biotechnology Investment Tax Credit, Businesses that Create New Jobs Tax Credit, One Maryland.

Data sources:

- Maryland Tax Expenditure Report, FY 2018
- Maryland Tax Expenditure Report, FY 2016

Methodological notes:

- FY 2014 data are from the FY 2016 Tax Expenditure Report. Data for all other years from the 2018 report.

Offset Capital Gains Special Treatment

Description: Levy a 1 percent surtax on capital gains income, which is taxed at a lower rate than ordinary income at the federal level.

Data sources:

- HB 956 of 2012 Fiscal and Policy Note
- IRS Historic Table 2
- Bureau of Economic Analysis data on Maryland personal income

Methodological notes:

- HB 956 of 2012 would have levied a 2 percent surtax on capital gains income. Revenue estimates for FY 2014 through FY 2017 are one-half of each year’s estimate from the fiscal note.
- The 2012 fiscal note did not include a revenue estimate for FY 2018, and data on capital gains income in 2018 are not yet available.
• MDCEP estimated Maryland capital gains as a share of total personal income in each calendar year based on IRS Historic Table 2 and BEA data on personal income. During this period, capital gains averaged 2.68 percent of total personal income.

• Maryland personal income totaled $382.8 billion in calendar year 2018. If capital gains income was 2.68 percent of this total, it would be slightly over $10.2 billion.

• MDCEP estimated capital gains in each fiscal year by averaging historical data from the applicable calendar years, yielding FY 2018 estimated capital gains of $10.8 billion.

• Based on estimated capital gains by fiscal year, the HB 956 fiscal note implies an effective tax rate of 1.92 percent, slightly below the 2.00 percent statutory tax rate.

• Halving the HB 956 effective tax rate and multiplying by estimated FY 2018 capital gains income yields a FY 2018 revenue estimate of $103.6 billion.

**Close the Carried Interest Loophole**

**Description:** Levy a 17 percent tax on performance-related income of certain investment fund managers to offset federal taxation of this income at the lower capital gains rate.

**Data sources:**


• HB 915 of 2017 Fiscal and Policy Note

**Methodological notes:**

• The Joint Committee on Taxation documents include estimates of the nationwide revenue gain from closing the carried interest loophole at the federal level.

• For each fiscal year, the JCT estimate from the same federal fiscal year’s document is used. For example, MDCEP’s SFY 2014 estimate is based on the JCT estimate in the document prepared for the president’s FFY 2014 budget.

• In the fiscal note for HB 915 of 2017, the Department of Legislative Services estimates that 3 percent of nationwide carried interest is attributable to Maryland. MDCEP uses the same assumption.

**Fix the Millionaire Estate Tax**

**Description:** Repeal Chapter 612 of 2014, lowering the state estate tax exemption to its earlier value of $1 million.

**Data sources:**

• HB 552 of 2016 Fiscal and Policy Note

**Methodological notes:**

• The fiscal note for HB 552 of 2016 includes an estimate of the revenue loss from Chapter 612 of 2014.
Maryland's $4 Billion Missed Opportunity

See Appendix for data sources and methodology. All revenue estimates are for all state funds.

MDCEP analysis of school funding adequacy data presented by the Department of Legislative Services to the Commission on Innovation and Excellence in Education.
